

Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 TOKYO 13047

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EA FOR DAS HEGINBOTHAM ONLY

E.O. 11652: GDS
TAGS: EGEN, JA
SUBJECT: ECONOMIC POLICY PAPER ON JAPAN

REF: TOKYO 13024

1. FOLLOWING IS OUR REWRITE OF DRAFT OUTLINE PAPER HAND-CARRIED TO TOKYO BY ALAN ROMBERG. IN ADDITION TO THE POINTS MADE REFTEL, THIS DRAFT REFLECTS POST-SUMMIT SITUATION AND THE CONSIDERABLE JAPANESE UNDERTAKINGS AT BONN.
2. BACKGROUND: SINCE JANUARY OUR ECONOMIC RELATIONS WITH JAPAN HAVE OPERATED WITHIN A FRAMEWORK DEFINED BY THE STRAUSS-USHIBA STATEMENT OF JANUARY 13 AND THE TRADE FACILITATION COMMITTEE TERMS OF REFERENCE. OVERALL PERFORMANCE HAS BEEN MIXED. MAJOR OBJECTIVES INCLUDED HIGHER GROWTH IN JAPAN, A LARGER CONTRIBUTION TO THE MTNS INCLUDING "SUBSTANTIALLY EQUIVALENT COMPETITIVE OPPORTUNITY," AND SIGNIFICANT PROGRESS IN THE DIRECTION OF CURRENT ACCOUNT BALANCE. JAPAN'S GNP GROWTH STILL APPEARS TO BE FALLING SHORT OF THE 7 PERCENT TARGET, BUT HAS NEVERTHELESS BEEN FAR BETTER THAN EARLIER EXPECTED AND
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BETTER THAN THAT OF ALL OTHER OECD COUNTRIES. AND IT NOW APPEARS FUKUDA WILL RECONVENE THE DIET TO ADOPT FURTHER STIMULATIVE MEASURES AIMING AT 7 PERCENT GROWTH. IMPORTANT PROGRESS HAS BEEN MADE ON A LONG LIST OF MTN ISSUES. SOME TOUGH NEGOTIATING REMAINS ON AGRICULTURAL TRADE AND CERTAIN INDUSTRIAL PRODUCTS ALTHOUGH, AGAIN POST-SUMMIT INDICATIONS, AT LEAST ON THE LATTER, SEEM

FAVORABLE. THE BROAD LONG RANGE ISSUE OF ACHIEVING SUBSTANTIALY EQUIVALENT COMPETITIVE OPPORTUNITY IS OPEN AND WILL REQUIRE FURTHER EVALUATION. ITS ACHIEVEMENT RELATES CLOSELY TO JAPAN'S ACHIEVEMENT OF CURRENT ACCOUNT EQUILIBRIUM. THE RECORD ON CURRENT ACCOUNT SO FAR HAS SHOWN NO IMPROVEMENT AND EVEN SOME WORSENING IN THE EARLY MONTHS OF THE YEAR. ON A LONG LIST OF OTHER ITEMS COVERED IN THE STRAUSS-USHIBA STATEMENT USEFUL PROGRESS HAS BEEN MADE. SEVERAL TRADE ORIENTED MISSIONS HAVE BEEN EXCHANGED. USEFUL IMPROVEMENTS IN IMPORT PROCEDURES HAVE BEEN MADE. VIRTUALLY ALL OF THE EASY PARTS OF THE STATEMENT HAVE BEEN ACCOMPLISHED. THE RESULTING TRADE IMPACT HAS BEEN SMALL, BUT NO ONE EXPECTED OTHERWISE, AND THE EFFORT HAS BOUGHT TIME.

3. AT THE SUMMIT, FUKUDA ANNOUNCED HIS RESOLVE TO ATTAIN A HIGH RATE OF GROWTH--7 PERCENT--EXPAND IMPORTS AND CURB EXPORTS EVEN THOUGH REGULATION IS NOT DESIRABLE. HE IN ESSENCE RENEWED JAPANESE PLEDGES TO ACT BECAUSE "WE ARE ALL IN THE SAME BOAT."

4. JAPAN HAS ANNOUNCED A PROGRAM OF RESTRAINTS ON MAJOR EXPORTS. ARTIFICIAL RESTRAINTS ARE DECIDEDLY NOT OUR PREFERRED SOLUTION FOR TRADE BALANCE PROBLEMS AND WE SHOULD HOLD NO ILLUSIONS ABOUT THEIR EFFECTIVENESS. THE
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SAME CAN BE SAID ABOUT JAPAN'S EMERGENCY IMPORT PROGRAM. WE CAN HAVE NO ENTHUSIASM FOR EMERGENCY IMPORTS WHICH MERELY ADVANCE THE DATE OF SALES WHICH WOULD HAVE OCCURRED IN ANY EVENT. ON THE OTHER HAND, A DETERMINATION BY THE GOJ TO HOLD DOWN IMPORTS SHOULD HAVE SOME SHORT-TERM POLITICAL VALUE, AND TO THE EXTENT THAT NEW TRADE TAKES PLACE, EMERGENCY IMPORTS HAVE SOME IMMEDIATE IMPACT.

5. AT LEAST FOR THE PRESENT, THE JAPANESE HAVE IN PLACE THE MACROECONOMIC POLICIES WHICH SHOULD EVENTUALLY LEAD TO A MAJOR TURNAROUND IN THEIR EXTERNAL POSITION. BOTH FISCAL AND MONETARY POLICY HAVE BEEN EASED IN A MAJOR WAY; INFLATION IS MUCH LESS OF A RESTRAINT; AND, REGARDLESS OF WHETHER THEY HIT 7 PERCENT ON THE HEAD, IT SEEMS IN THE CARDS THAT THEY WILL GROW FASTER WHILE AT LEAST ONE OF THEIR MAJOR TRADING PARTNERS--THE U.S.--GROWS MORE SLOWLY. WHILE WE TALK ABOUT A 30 PERCENT APPRECIATION OF THE YEN OVER THE PAST YEAR AND A HALF, WE SHOULD NOT OVERLOOK THAT THAT TRANSLATES INTO A 45 PERCENT DEPRECIATION OF THE DOLLAR. WE WOULD BE HIGHLY SURPRISED IF THIS PATTERN OF CHANGES ON BOTH THE INCOME AND PRICE SIDES DID NOT PRODUCE THE INTENDED EFFECTS.

6. BUT WE DON'T KNOW WHEN, AND WE HAVE RATHER SERIOUS DOUBTS THAT ANYONE ELSE DOES. IT THUS SEEMS TO US THAT, EVEN IF WE ARE RIGHT AND THE SURPLUS IS GOING TO COME DOWN, OUR STRATEGY MUST TAKE THE UNCERTAINTY AS TO TIMING INTO ACCOUNT.

7. OBVIOUSLY, WE SHOULD OPERATE ON THE ASSUMPTION THAT THERE IS A SURPLUS PROBLEM AS LONG AS THERE IS A SURPLUS.

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C O N F I D E N T I A L SECTION 02 OF 03 TOKYO 13047

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ONE ELEMENT IN OUR LONG-RANGE STRATEGY MUST CERTAINLY BE TO DO WHATEVER WE CAN TO URGE JAPAN TO CONTINUE TO OPEN ITS ECONOMY. WHEN THE SURPLUS DECLINES, OUR LEVERAGE WILL BECOME LESS. SO THE PRESENT LARGE SURPLUS PRESENTS AN OPPORTUNITY. THUS THERE IS NO DOUBT IN OUR MINDS THAT WE WANT TO MOVE AHEAD ON AS MANY FRONTS AS IS REASONABLE-- THE SUB-CABINET, THE TFC, THE STRAUSS-USHIBA MEETING IN OCTOBER. THE JOB WON'T BE FINISHED SOON AND WE SHOULD PRESS AHEAD NOW.

8. U.S. OBJECTIVES: IT IS PROBABLY TIME TO MOVE AWAY FROM THE SHOT-GUN APPROACH OF PREPARING LONG LISTS OF THINGS THAT JAPAN MIGHT DO AND USING THEM FOR A BASIS FOR ARGUING STOUTLY FOR WHATEVER WE CAN GET. OVERALL ECONOMIC GROWTH IS UNQUESTIONABLY USEFUL, BUT THE MAJOR BILATERAL ECONOMIC ISSUE IN 1978 IS JAPAN'S VERY LARGE CURRENT ACCOUNT SURPLUS. BEYOND THAT ISSUE IS THE MUCH MORE DIFFICULT QUESTION OF RESTRUCTURING JAPAN'S ECONOMY TO ELIMINATE THE EXPORT BIAS WHICH IS THE UNDERLYING CAUSE OF THE SURPLUS. THIS LATTER ISSUE IS A DIFFICULT ONE AND PROGRESS ON IT MUST BE SLOW. NEVERTHELESS,

RESTRUCTURING IS ABSOLUTELY ESSENTIAL. IN BRIEF WE
SEEK A JAPANESE CURRENT ACCOUNT IN EQUILIBRIUM AND A
RESTRUCTURING OF THE JAPANESE ECONOMY WHICH WILL KEEP IT
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THERE.

9. U.S. APPROACH; STYLE: THE STYLE WE USE IN APPROACHING
THE JAPANESE WILL BE EXCEEDINGLY IMPORTANT. WHICH STYLE
TO CHOOSE IS A LEGITIMATE TOPIC FOR DEBATE. THREE BASIC
ALTERNATIVES CAN BE DEFINED, ALTHOUGH EACH TENDS TO FLOW
INTO THE OTHERS, AND IT IS ALWAYS POSSIBLE TO EMPLOY A
JUDICIOUS MIXTURE. THE DIFFERENT STYLES MAY BE DESCRIBED
AS:

(A) LOW KEY. ISOLATE THE THINGS THE JAPANESE ARE DOING
RIGHT AND ENCOURAGE AND SUPPORT THEM IN THOSE AREAS.
POINT OUT THE BEST ASPECTS OF THE 1978 MITI WHITE PAPER
(TOKYO 11981). STAY AWAY FROM PUBLIC STATEMENTS. SYM-
PATHIZE WITH THEM IN THE MANY PROBLEMS THEY MUST SOLVE,
WHILE EXPRESSING CONFIDENCE IN THEIR ABILITY TO DO WHAT
THEY SHOULD.

(B) STATE EXPLICITLY WHAT IT IS THAT JAPAN NEEDS TO DO AND
HOW QUICKLY IT MUST BE DONE. POINT OUT NEGATIVE CONSE-
QUENCES IN CASE OF FAILURE. MAKE THESE POINTS PRIVATELY,
PUTTING PRESSURE ON STRONGLY BUT WITHOUT ISSUING ANY
PUBLIC THREATS.

(C) USE A MUCH MORE PUBLIC APPROACH. STATE OPENLY AND
SEEK PUBLICITY FOR OUR VIEWS ON WHERE JAPAN HAS FAILED
OR SEEMS TO BE FAILING, POINTING OUT IN CLEAR TERMS WHAT
MAY HAPPEN IF THINGS DON'T CHANGE.

AT THIS POINT WE DON'T THINK THE FIRST APPROACH IS ACCEP-
TABLE. OUR PROBLEMS ARE TOO SERIOUS, AND THE RISK OF
PROTECTIONIST LEGISLATION OR OTHER ACTIONS WHICH BOTH
SIDES DO NOT WANT IS TOO GREAT TO BE IGNORED. PRIVATE
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REPROACHES HAVE ALWAYS BEEN USEFUL, BUT UNDER PRESENT
CIRCUMSTANCES WE BELIEVE THAT ON OCCASION IT WILL BE
NECESSARY TO GO PUBLIC. AT TIMES THE JAPANESE THEMSELVES
ISSUE RINGING DEFENSES OF THEIR CONDUCT TO THE MEDIA.
WHEN THEY DO WE MAY WISH TO RESPOND. WE MAY DECIDE TO
TAKE THE INITIATIVE ON OTHER SUBJECTS. WE CAN DO SO IN

CLEAR TERMS WHILE AVOIDING THE STRIDENCY WHICH ONLY
NEGATES THE VALUE OF WHAT WE SAY. WE SHOULD TRY TO CREATE
ATMOSPHERE IN WHICH JAPAN WILL NOT SIMPLY RESPOND TO OUR
DEMANDS BUT WILL COME FORWARD WITH SUGGESTIONS OF THEIR
OWN ABOUT STEPS THEY ARE TAKING TO IMPROVE THEIR PUBLIC
IMAGE AS AN OPEN TRADING NATION.

10. U.S. APPROACH; CONTENT: OUR FUNDAMENTAL MESSAGE
INCLUDES THE TWO POINTS: CURRENT ACCOUNT BALANCE, AND
RESTRUCTURING OF THE ECONOMY, AS OUTLINED IN THE SECTION
ON U.S. OBJECTIVES. THERE ARE ADDITIONAL ACTIONS WE
CAN TAKE FOR THEIR COSMETIC EFFECT AND TO BUY TIME.
EARLY PHASING OF MTN TARIFF CUTS ARE ONE EXAMPLE. SIGNI-
FICANT LIBERALIZATION OF CITRUS AND BEEF QUOTAS ARE
ANOTHER. WE COULD SEEK A GOJ CABINET ORDER TO SUPPORT
THE TFC AND ESTABLISH SENIOR CONTACTS IN EACH MINISTRY.
JAPAN COULD INCLUDE MACHINERY IMPORTS IN ITS LOW-RATE
EMERGENCY IMPORT PROGRAM. IN AN ATMOSPHERE OF MUTUAL
COOPERATION WE CAN DISCUSS FUTURE STEPS TO BE TAKEN IN
THE TFC OR PERHAPS TO ENGAGE THE JAPANESE CABINET
ECONOMIC COMMITTEE MORE FULLY IN PROMOTING IMPORTS. WE
SHOULD BE ABLE TO IDENTIFY OTHERS, WHILE AVOIDING A

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"GRAB-BAG" APPROACH WHICH MAKES US LOOK AS IF WE ARE NOT
REALLY SERIOUS ABOUT ANYTHING. THE TRADE FACILITATION
COMMITTEE AND TRADE STUDY GROUP CONTINUE TO BE EXTREMELY
USEFUL TOOLS FOR DEALING WITH SPECIFIC AND GENERAL QUES-
TIONS. WE WILL PUSH FOR SUCCESS IN AS MANY ISSUES AS WE
CAN, BUT IT IS NOT NECESSARY FOR EVERY CASE OR STUDY TO
PRODUCE POSITIVE RESULTS. EVEN THE "FAILURES" CAN BE

TURNED TO OUR ADVANTAGE IF WE USE THE TFC/TSG PROCEDURES TO DEFINE THE PROBLEM, OBTAIN JAPANESE VIEWS ON IT, AND EVENTUALLY PERSUADE THE JAPANESE TO GIVE US USEFUL CONCESSIONS. IF NECESSARY, PROBLEMS CLARIFIED BY THE TFC/TSG CAN BE ELEVATED TO A POLITICAL LEVEL AND OUR POINTS MADE MUCH MORE PERSUASIVELY ON ACCOUNT OF THEIR HAVING BEEN THOROUGHLY PREPARED.

11. FORUMS: ALL OF THIS APPROACH DESCRIBED ABOVE CAN BE PURSUED AT THE SUB-CABINET MEETING PLANNED FOR SEPTEMBER, 1978. THE SUB-CABINET MEETING WILL CAUSE THE JAPANESE TO ADDRESS ALL OUTSTANDING ISSUES ON AN INTER-AGENCY LEVEL AND OBLIGE THEM TO CLARIFY THEIR THINKING AND ENERGIZE POSITIVE ACTION PROGRAMS. THE SUB-CABINET MEETING CAN BE A DEVICE FOR ENCOURAGING WIDE PARTICIPATION BY THE JAPANESE BUREAUCRACY AND FOCUSING PUBLIC ATTENTION ON HOW THEY ARE DOING. WE NEED NOT LOOK UPON THIS AS AN INTIMATE CONFIDENTIAL

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LITTLE GATHERING TO BE CONDUCTED IN A QUIET ATMOSPHERE OUT OF THE PUBLIC EYE.

12. THE MTNS ARE STILL A MAJOR FORUM. CONCESSIONS ON AGRICULTURE WILL NOT HAVE A MASSIVE EFFECT ON THE CURRENT ACCOUNT BALANCE, BUT WILL PROVIDE USEFUL IMPROVEMENTS IN POLITICALLY SENSITIVE AREAS.

13. A STRAUSS-USHIBA FOLLOW-UP MEETING IS PROJECTED FOR OCTOBER. THIS CAN BE A CONTEXT FOR TAKING UP SPECIFIC TRADE ISSUES, PARTICULARLY INCLUDING THOSE IDENTIFIED THROUGH TFC/TSG PROCEDURES BUT ON WHICH LITTLE PROGRESS HAS BEEN MADE. CONSIDERATION MIGHT BE GIVEN TO HOLDING THAT MEETING IN TOKYO IN ORDER TO MAXIMIZE ITS IMPACT IN JAPANESE MEDIA.

14. AN EPA/CEA CONSULTATION IN THE SECOND QUARTER OF 1979 WOULD BE USEFUL. THIS FORUM CAN COPE BETTER THAN ANY OTHER WITH DIFFICULT ISSUES SUCH AS ECONOMIC RESTRUCTURING. WHILE AT THIS POINT NO DECISIONS HAVE BEEN MADE, IT IS NOT TOO SOON TO THINK ABOUT THE OPPORTUNITIES OFFERED BY A PRESIDENTIAL VISIT IN 1979, POSSIBLY TO BE HELD AS AN ADD-ON TO A TOKYO ECONOMIC SUMMIT. AN ECONOMIC SUMMIT IN TOKYO COULD BE AN "ACTION FORCING" EVENT FOR THE JAPANESE. IT WOULD CREATE STRONG PRESSURE ON THEM TO HAVE SOMETHING GOOD TO POINT TO. THE JAPANESE ACCOMPLISHED GREAT THINGS BEFORE THE 1964 OLYMPICS AND USEFUL THINGS BEFORE PRESIDENT FORD'S VISIT, AND SUCH EVENTS MAKE THEM WORK TO PUT THEIR HOUSE IN GOOD ORDER. MANSFIELD

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